Attachment 7

WILSHIRE CONSULTING

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Managing Director & Principal

April 10, 2008

Dr. Russell Read
Chief Investment Officer
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Infrastructure Program Policy

Dear Russell,

You requested Wilshire's opinion with respect to Staff's proposed policy for the Infrastructure program, which we received last night. Although we were not invited to comment on this document over the last seven months like the other constituent groups, despite the Investment Committee naming us as the consultant for the entire Inflation-Linked Asset Class, our comments and recommendation regarding this policy are below.

Recommendation

In Wilshire's opinion, this policy is a good start toward defining the investment guidelines for the program and asset class, but lacks any specific limits or guidelines to mitigate a number of investment-related risk factors in the portfolio. As a result, in our opinion, we believe that Staff should insert clear limits on how this program will be invested and how excessive risk will be eliminated. We recommend that the Policy Subcommittee approve the Policy in its current form as a first reading, but require Staff to return for a second reading with specific investment-related risk controls.

Background and Supporting Information

While we believe that this policy does a good job listing some of the various types of investments in which the program may invest and some of the risk factors inherent in an investment program of this type, we believe that it is appropriate for the policy to contain more specific guidance for Staff to prevent excessive risk within the portfolio. We have outlined, below, several of these areas which could benefit from stated risk controls, and we would be happy to speak with you, members of your Staff, or the Investment Committee about the full list of sections that we believe should be tightened.

Section VI.J.3.a – "(Staff shall) assess the level of diversification in the portfolio on a continual basis, including the level of diversification across investment style, geographic distribution, industry concentrations, and across other ranges as appropriate." We believe that all three of these factors (style, geography, and industry) should have some stated constraints. While the policy says that Staff shall "assess" these factors, there is no rule contained in this policy which prevents Staff from "assessing" that the appropriate investment portfolio consists of only a single investment type in a single industry in a single city. Although we do not doubt that Staff intends to diversify this portfolio, we believe that the requirement to do so should be more clearly stated.

Section VI.K.1 – "Financial Risk: Infrastructure investments may employ substantial leverage (borrowing), which may result in significant financial risk." We note that the Forestland policy's leverage limit was the subject of much debate at a recent Policy Subcommittee meeting, and we believe that a limit on leverage on both individual investments and the program as a whole should be contained in this policy, as it is in the Forestland policy.

Section VI.K.2 – "Liquidity Risk". Nowhere in the policy is there any discussion of the requirement of Staff to seek some stated level of liquidity, or what the Investment Committee's expectation of liquidity will be. We recognize that this may be a difficult area to clearly define, and only raise this concern in light of so many other areas we believe should be strengthened.

Section VI.K.3 – "Credit Risk." As with the "Financial Risk" section, Credit Risk can be clearly defined, and the limits on the credit risk of counterparties / partners on individual deals and for the program as a whole should be explicitly stated.

Section VI.K.7 – "Country Risk: Political, economic, and currency risks are associated with investing in countries." We agree that this is a risk, and therefore we believe that an explicit statement of how limits on individual countries will be determined is appropriate, as well as guidance on how currency risk will be managed.

Sections VII.B.1-7 – "Permissible Investments" lists many of the possible types of investment structure available to CalPERS, but places no limits on the allocations to any particular type.

Sections VII.D-F – "Diversification by Geography, Revenue and Strategy, and Asset Size", as stated above, contain no constraints on how Staff may invest the assets, with the exception of language preventing one source of revenue or "large or small investments" from "dominating" the portfolio. Given the myriad of ways one could interpret "dominating", we do not believe that this is a sufficiently explicit limit.

Section VII.H-I – "Use of Leverage" and "Credit Rating". Please see comments above.

Conclusion

As stated above, we believe that a policy governing a new, multi-billion dollar portfolio in an asset class in which CalPERS has little history as an institution should contain clearly stated limits on Staff's ability to incur risk in the areas of lack of diversification, credit, leverage, and liquidity. As a result, we believe that this policy requires the addition of specific risk limits on a number of areas before it should be accepted by the Policy Subcommittee and Investment Committee.

We look forward to working with Staff to include more specific guidelines and constraints. Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,